

Is Social Security All I Need for Retirement Income?

- Retirees generally need about 70 percent of pre-retirement income to live comfortably according to financial advisors.
- Social Security is only one piece of retirement income security, on average replacing 41 percent of pre-retirement income. Workers need to accumulate personal savings and pension income to be financially secure in retirement.
- On average, 40 percent of retirement income comes from Social Security. It was the major source of income for two-thirds of beneficiaries and the only source of income for almost 20 percent of beneficiaries.
- Only 42% of retirees have pension benefits and only half of current workers are covered by pensions.
- The personal savings rate has dropped from 9.3 percent in 1946 to 2.1 percent in 1997.
- Retirees with income from savings such as assets tend to have much higher incomes than those without asset income.

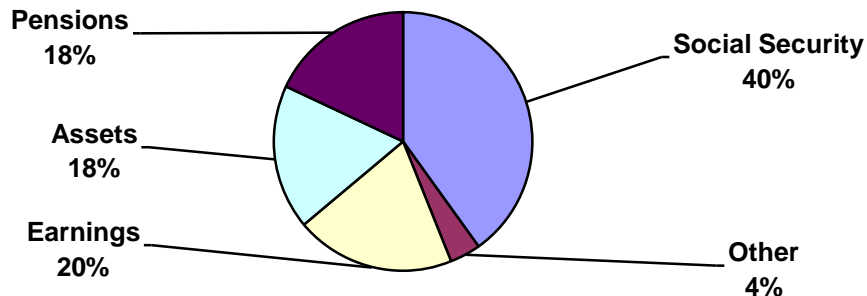
Retirement Income Needs

Financial advisors often tell people that they will need about 70 percent of pre-retirement income to live comfortably in retirement.¹ Workers should develop income from the three sources of retirement income that have been referred to as the legs of the "three-legged stool:" Social Security, pension income and personal savings.

Retirement Income Sources

Retirees rely on a variety of income sources for retirement income. These sources include the "three legs" mentioned above as well as earnings and public assistance. As the chart below shows, 40 percent of retirees' income came from Social Security, 18 percent came from employer pensions, 18 percent came from asset income (including savings) and 20 percent came from earnings in 1996.

Social Security, Pension and Asset Income are Major Income Sources for the Aged

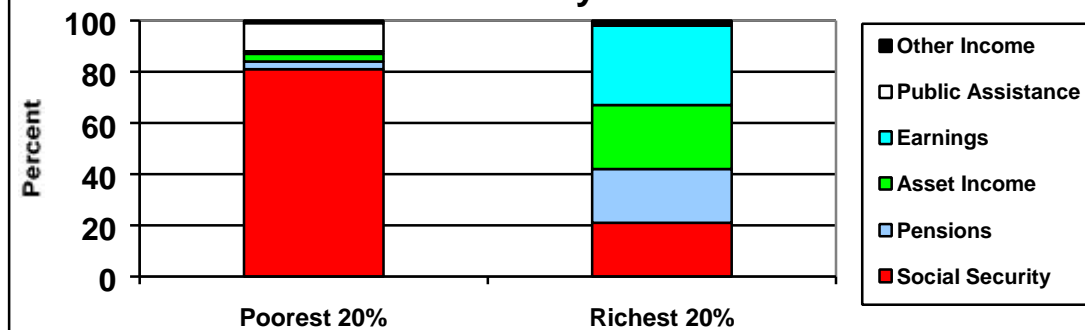


Source: Fast Facts and Figures About Social Security, 1998

The trend in reliance on these various income sources has been away from public assistance and earnings and going towards Social Security, pensions and asset income. However, reliance on various income sources differs greatly between the poorest 20 percent and wealthiest 20 percent of retirees, as the chart below illustrates. Nearly all of pension and savings income goes to the wealthier half of the retired population.

- In 1996, only 7.5 percent of all pension income went to retirees in the bottom half of the income distribution.
- Only 6.5 percent of all savings was held by individuals in the bottom half of the income distribution.

Lower-Income Elderly Rely Heavily on Social Security



Source: Income of the Aged Chartbook, 1996, Table VII.5.

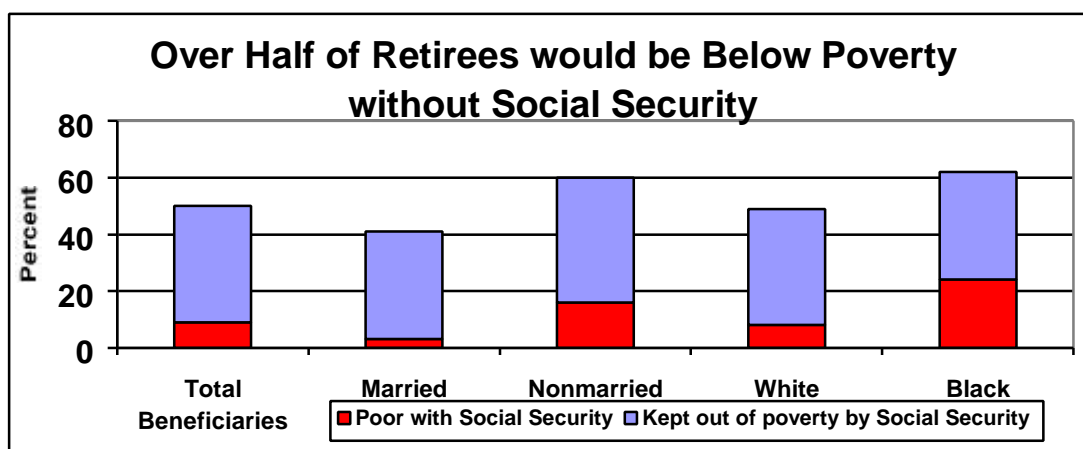
Social Security's Role in Retirement Security

Social Security plays an important role in providing retirement income. It is the foundation on which to build financial security in retirement. Social Security benefits are the major source of income for two-thirds of retirees 65 and over and it represents 90 percent or more of income for about a third of those aged 65 and over. Nearly all retirees, more than 9 out of 10, receive Social Security benefits.²

For a worker with average wages (\$28,924 in 1999),³ Social Security replaces about 40 percent of pre-retirement earnings. However, this varies by income because of Social Security's progressive benefit formula. Workers retiring in 2000 at age 65 will have a replacement rate of:

- about 53 percent if they were low earners (\$13,100 in 1999);
- about 32 percent if they were high earners (\$46,663 in 1999);
- about 24 percent if they earned the taxable maximum (\$72,600 in 1999).⁴

Many low-income retirees depend on Social Security benefits to get by. The poverty rate for retirees, if they did not receive Social Security, would be about 50 percent, as shown in the chart below.



Source: Income of the Aged Chartbook, 1996

Pension Income's Role in Retirement Security

Income from employer-sponsored pensions is the second piece of retirement income security. Employer-sponsored pensions are voluntary and not all employers offer them. About 42 percent of people over age 65 received pension income in 1994.⁵ The receipt of pension benefits differs by age group: younger retirees are more likely to have income from private pensions and other pensions than older retirees.

- Almost a third of retirees 65-69 years of age received private pension income, compared to 20 percent of those 85 and older.
- About 15 percent of retirees 65-69 years of age received income from other pensions compared to 10 percent of those 85 and older.⁶

About half of all workers are covered by an employer-sponsored pension. Over the last 20 years a gender gap in pension coverage rates has narrowed because men's coverage rates declined while women's coverage rates increased. Pension coverage is especially low for employees in small firms. Only 11 percent of employees working for a private organization employing fewer than 25 workers participate in some employer-sponsored pension compared to 68 percent of those in organizations that employ 1000 or more people.⁷

The type of employer-sponsored pension plan has been shifting from defined benefit (fixed payment) to defined contribution (fixed contribution - variable payment) over the last couple of decades. A 1996 General Accounting Office (GAO) report found that among private employers offering a single-employer pension plan, almost 90 percent offered a defined contribution plan only, up from nearly 70 percent in 1984.⁸ The type of pension plan differs according to the size of the firm. Many large employers tend to have defined benefit plans, or defined benefit and defined contribution plans while the majority of small employers tend to have only defined contribution plans.

Much of the growth in defined contribution plans has come from the growth of 401(k) plans. These plans are profit-sharing and stock bonus pension plans. Participation is voluntary and many workers chose not to participate, and when they do participate their contributions are often low, even though contributions are made from pre-tax earnings. 401(k) plans have grown from 3 percent of all pension plans in 1984 to 20 percent of all pension plans in 1992.⁹

This shift from defined benefit to defined contribution means that pension income has become a less certain source of income in recent years. Defined contribution

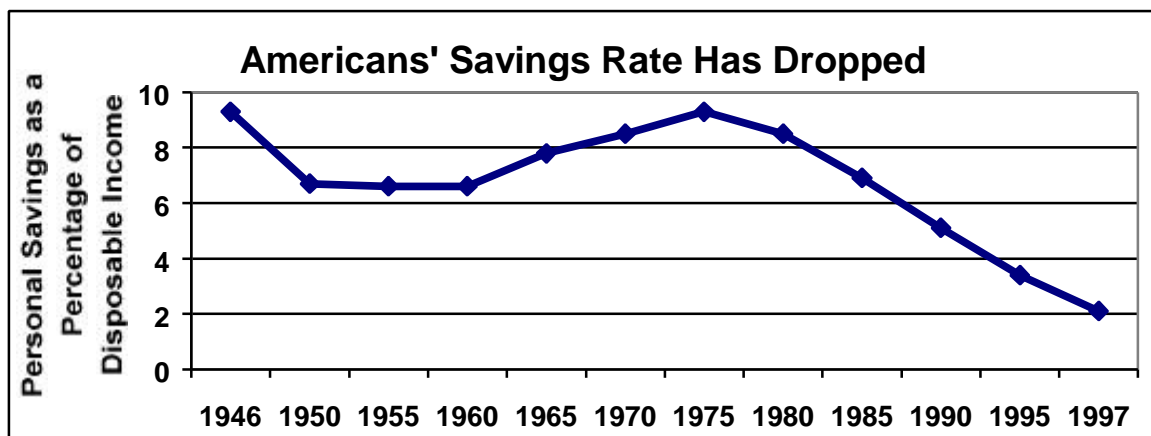
plans, especially 401(k) plans, typically involve higher risk for the worker because they bear the investment risk and their pension benefit is not guaranteed or constant. The result of this shift in pension income is that Social Security's defined benefit has become more important to retirees.

The distribution of pension benefits has been shifting away from an annuity towards a lump-sum payment or a mix of lump-sum and annuity. Between 1989 and 1994, the percentage of pension recipients receiving only an annuity dropped from 52 percent to 38 percent while those receiving only lump-sum distributions rose from 40 percent to 51 percent.¹⁰

The Role of Personal Savings Has Diminished

Savings is the third element of retirement income and is the one income source that can be most influenced by the individual. The more personal savings put aside for retirement, the higher the retirement income. Income from personal savings typically includes income from assets.

Personal savings rates have fallen since World War II. The savings rate has fallen from 9.3 percent of disposable income in 1946 to 2.1 percent in 1997, as shown in the chart below. A poll conducted by Fidelity Investments/Public Agenda in 1997 found that nearly half of Americans had saved less than \$10,000 for retirement. This figure includes all savings including savings accounts, bonds and mutual funds.

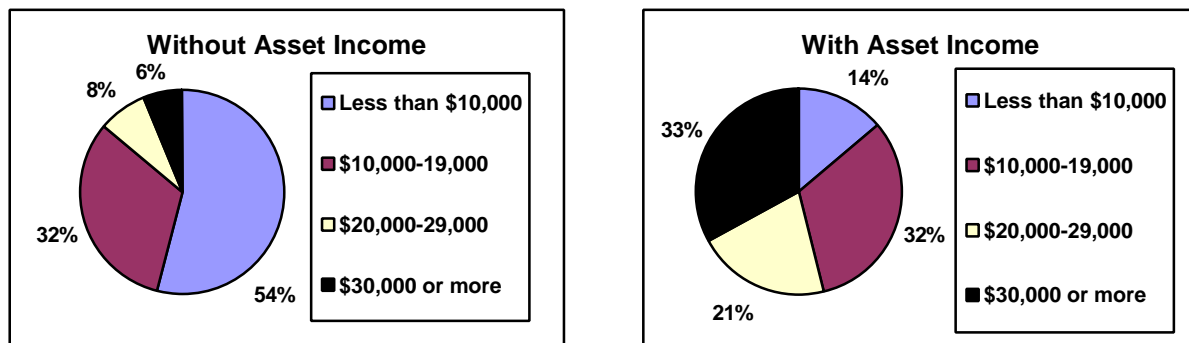


Source: *Survey of Current Business*, Department of Commerce, Bureau of Economic Analysis, August 1998.

The presence of income from assets can mean a substantially higher retirement income. The median income of those retirees with asset income is more than twice as

large as the income of retirees with no asset income. As the two pie charts show below, retirees without asset income are concentrated in the lowest income categories.

Retirees with Income from Assets have Higher Retirement Income



Source: Income of the Aged Chartbook, 1996

ENDNOTES

¹ Social Security: Basic Facts. Social Security Administration Publication 05-10080, 1996.

² Income of the Aged Chartbook, 1996

³ Estimated from Table III.B5 of the 1999 Trustees Report.

⁴ 1999 Trustees Report, Table III.B5.

⁵ New Findings from the September 1994 Current Population Survey, Pension and Welfare Benefits Administration, U.S. Department of Labor, 1995.

⁶ Income of the Aged Chartbook, 1996

⁷ New Findings from the September 1994 Current Population Survey, Pension and Welfare Benefits Administration, U.S. Department of Labor, 1995.

⁸ Most employers that offer pensions use defined contribution plans, General Accounting Office, 1996. GGD-97-1

⁹ Facts from EBRI: Private Pension Plans, Participants, and Assets, 1997.

¹⁰ New Findings from the September 1994 Current Population Survey, Pension and Welfare Benefits Administration, U.S. Department of Labor, 1995.